

Message Text

CONFIDENTIAL

PAGE 01 MANILA 14462 01 OF 02 201520Z

43

ACTION EA-09

INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-04 H-02 INR-07 L-03

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R 201000Z SEP 76

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 462

C O N F I D E N T I A L SECTION 1 OF 2 MANILA 14462

E.O. 11652: GDS

TAGS: ENRG, RP ISSUED

SUBJECT: DECISION ON CALTEX/MERALCO DISPUTE

1. SUMMARY. PRESIDENT MARCOS ISSUED HIS REVIEW DECISION ON THE CALTEX/MERALCO PPC PRICE DISPUTE SEPTEMBER 17. PRESS PLAYED STORY STRAIGHT WITHOUT ANTI-CALTEX BIAS. IT REQUIRES CALTEX TO REIMBURSE MERALCO P60.5 MILLION FOR QUOTE OVERPRICING END QUOTE SINCE OCTOBER 1, 1974. THE PRESIDENT ORDERED MERALCO TO MAKE CORRESPONDING REFUNDS TO ITS CUSTOMERS. CALTEX CONSIDERS THIS CONFISCATORY. THE ROLE THAT PNOC PRESIDENT VELASCO AND MRS. MARCOS' BROTHER "KOKOY" ROMUALDEZ PLAYED IN THE DISPUTE SETTLEMENT IS DISTRUBING AND A BAD OMEN FOR THE INVESTMENT CLIMATE, PARTICULARLY IN THE PETROLEUM SECTOR. END SUMMARY.

2. THE PRESIDENT ISSUED HIS REVIEW DECISION SEPTEMBER 17 ON THE LONG STANDING PRICE DISPUTE BETWEEN CALTEX AND ITS MAJOR CUSTOMERS, MANILA ELECTRIC COMPANY (MERALCO) AND PHILIPPINE PETROLEUM CORP. THE DECISION UPHOLDS A MAY 29 RULING BY THE OIL INDUSTRY COMMISSION (OIC) THAT CALTEX MUST SUPPLY MERALCO FUEL OIL AT AN OIC CEILING PRICE OF P120.11 A BARREL RATHER THAN THE CONTRACT PRICE OF P131. THE PRESIDENT'S DECISION ALSO MAKES
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 MANILA 14462 01 OF 02 201520Z

THE PRICE RETROACTIVE WHEREAS THE OIC DECISION DID

NOT. THE OIC RULING THAT CALTEX FEEDSTOCK SUPPLY TO PPC WOULD HENCEFORTH COME UNDER OIC PRICE CONTROLS WAS UPHELD BY THE PRESIDENT BUT NOT MADE RETROACTIVE. THE REVIEW DECISION ACCORDING TO CALTEX (PHILIPPINES) PRESIDENT WILLIAM DUNNING IS A CLEAR UNILATERAL ABROGATION OF LEGALLY VALID SUPPLY CONTRACTS CALTEX HAS WITH MERALCO AND PPC. IT WILL REQUIRE CALTEX TO REIMBURSE MERALCO P60.5 MILLION, AND THE REDUCTION IN CALTEX REVENUE AT FULL CONTRACT VOLUMES WILL BE P309 MILLION. AS A RESULT, CALTEX'S OVERALL OPERATION IN THE PHILIPPINES WILL BE ECONOMICALLY MARGINAL AT BEST ITS AYS.

3. CALTEX HAS PREVIOUSLY SUPPLIED MERALCO AND PPC, WHICH REPRESENT HALF OF ITS PHILIPPINE BUSINESS, UNDER LONG TERM CONTRACTS NEGOTIATED DURING THE 1973 OIL CRISIS WHICH INCLUDED PRICE ESCALATION CLAUSES INDEXED ON CALTEX CRUDE IMPORT COSTS. MERALCO AND PPC PETITIONED THE OIC TO DETERMINE THAT THESE CONTRACTS HAD LED TO QUOTE EXCESSIVE PRICES END QUOTE AND THAT CALTEX MUST SUPPLY MERALCO AND PPC AT OIC ESTABLISHED CEILING PRICES OR BELOW, AS DO OTHER OIL COMPANIES IN THE PHILIPPINES. THE MAY 29 OIC DECISION, WHILE FAVORABLE TO THE PETITIONERS, WAS NOT MADE RETROACTIVE. MERALCO AND PPC APPEALED TO THE OFFICE OF THE PRESIDENT ASKING THE OIC DECISION BE MADE RETROACTIVE TO THE STARTING DATES OF THE CONTRACTS, FEBRUARY 1974. WE UNDERSTAND THAT THE BASIS FOR THE PRESIDENT'S CHOICE OF THE OCTOBER 1 DATE FOR RETROACTIVITY IS THAT THIS UJZ THE FIRST DATE MERALCO APPROACHED CALTEX REQUESTING A DOWNWARD REVISION IN THE CONTRACT PRICE.

4. CALTEX'S PSITION IS THAT IT HAS LEGALLY BINDING CONTRACTS NEGOTIATED IN GOOD FAITH AND WITH PHILIPPINE GOVERNMENT APPROVAL. CALTEX FEELS THAT ANY REPAYMENT TO MERALCO ABOVE THAT IS VOLUNTARILY OFFERS IS CONFISCATORY AND WITHOUT BASIC IN FACT. THE OIC HAS GIVEN TWO DECISIONS IN THE QUESTION OF THE PRICE OF CALTEX FUEL OIL, THE FIRST IN EARLY 1975 UPOLDING THE CONTRACT PRICE AND THE SECOND IN MAY 1976 WHEREIN IT CONFIDENTIAL

CONFIDENTIAL

PAGE 03 MANILA 14462 01 OF 02 201520Z

ESTABLISHED A NEW PRICE BUT REJECTED RETORACTIVITY. THE LEGALITY OF THE CALTEX POSITION IS CLEAR, CALTEX BELIEVES.

CONFIDENTIAL

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CONFIDENTIAL

PAGE 01 MANILA 14462 02 OF 02 201537Z

43

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R 201000Z SEP 76

FM AMEMBASSY MANILA

TO SECSTATE WASHDC 463

C O N F I D E N T I A L SECTION 2 OF 2 MANILA 14462

5. RECOGNIZING THAT THE ESCALATION MECHANISM HAS RESULTED IN FUEL OIL PRICES ABOVE PRESENT IMPORT PARITY PRICES, CALTEX HAS OFFERED IN VARIOUS FORUMS TO NEGOTIATE A DOWNWARD PRICE ADJUSTMENT ON AN EXTRA CONTRACTUAL, EX GRATIS BASIS. AFTER THE MAY 29 DECISION WHEN MERALCO AND PPC INDICATED THEY WOULD APPEAL FOR RETROACTIVITY, AND AFTER JAMES VOSS, CHAIRMAN OF THE BOARD OF CALTEX, CALLED ON PRESIDENT MARCOS IN LATE JUNE, CALTEX EVEN INDICATED A WILLINGNESS TO CONSIDER OFFERING A LUMP SUM SETTLEMENT TOTALLING P35.4 MILLION COVERING A PRICE ADJUSTMENT TO BOTH MERALCO AND PPC BAK TO JANUARY 1, 1976.

6. AN AIDE MEMOIRE BY CALTEX GIVING DETAILED BACKGROUND ON THE CONTRACT DISPUTE AND STATING ITS POSITION ON THE MATTER IS BEING AIR-POUCHED TO EA-/PHL.

7. CALTEX HAS NOT YET DECIDED HOW TO RESPOND TO THIS DECISION. IT IS CLEARLY CONFISCATORY, CALTEX BELIEVES. IT WILL JEOPARDIZE CALTEX OPERATIONS HERE, BUT CALTEX DOES NOT WANT TO LEAVE THIS MARKET WHERE CALTEX HAS BEEN A GOOD CORPORATE CITIZEN FOR OVER 50 YEARS. CALTEX BELIEVES IT HAS BEEN UNFAIRLY TREATED IN THE LOCAL CONTROLLED PRESS THROUGHOUT THE OIC HEARINGS. CALTEX

CONFIDENTIAL

CONFIDENTIAL

PAGE 02 MANILA 14462 02 OF 02 201537Z

OFFICIALS BELIEVE THEIR COMPETITOR, PNOC CHAIRMAN VELASCO, HAS PLAYED AN INAPPROPRIATE INTERFERING ROLE IN BOTH THE OIC HEARINGS, PRESS ATTACKS, AND LATER ATTEMPTS TO REACH A GOOD FAITH NEGOTIATED SETTLEMENT WITH MERALCO AND PPC. WE CONCUR.

8. CALTEX CLAIMS THAT COMMERCIAL CONTRACTS ARE NOW EASILY BROKEN. MANY OF CALTEX'S OLD AND VALUED CUSTOMERS HAVE BEEN PIRATED BY PNOC UNDER VEILED THREATS OF GOVERNMENT PRESSURE. THE PNOC TANKER SCHEME IS STILL FRESH IN EVERYONE'S MINDS. CALTEX HAS RECEIVED THROUGHOUT THIS EPISODE THE MESSAGE THAT IT IS NO LONGER WELCOME IN THE PHILIPPINES AND THAT VERY STRONG FORCES ARE AT WORK TO FORCE CALTEX OUT OF THIS MARKET. ONLY PERSONAL ASSURANCES WHICH PRESIDENT MARCOS GAVE JAMES VOSS HAVE ASSURED CALTEX OTHERWISE.

9. COMMENT: THE SCENARIO OF THE OFFICIAL DECISION-MAKING PROCESS IN THIS DISPUTE IS INDICATIVE OF ONE OF THE FACTORS WHICH IS PRESENTLY TARNISHING THE INVESTMENT CLIMATE HERE FOR FOREIGN FIRMS. THE OIC HEARINGS GAVE THE ORIGINAL SETTLEMENT THE FACADE OF AN IMPARTIAL REVIEW OF A CONTESTED CONTRACT THAT WAS NO LONGER RELEVANT TO THE TIMES. HOWEVER, OUR CONTACTS TELL US THE FINAL OUTCOME WAS PREDETERMINED BY THE PALACE UNDER PRESSURE FROM VELASCO WHO WANTS A LARGER SHARE OF CALTEX BUSINESS FOR PNOC, AND FROM BENJAMIN "KOKOY" ROMUALDEZ, MRS. MARCOS' BROTHER WHO NOW CONTROLS MERALCO. THE PRESS ATTACKS DURING THE ORIGINAL OIC HEARINGS WERE ORCHESTRATED BY PNOC AND MERALCO TO PURPOSEFULLY DISCREDIT THE CALTEX PUBLIC IMAGE. THE PRESIDENTIAL APPEAL DECISION WAS WRITTEN IN PNOC, NOT BY AN IMPARTIAL THIRD PARTY. EVERY CALTEX INITIATIVE TO COME TO A REASONABLE NEGOTIATED SETTLEMENT WAS THWARTED BY VELASCO AND/OR ROMUALDEZ. PRESIDENTIAL DECISION, HOWEVER, WAS GIVEN STRAIGHTFORWARD TREATMENT IN THE PRESS.

10. THE MEANS OF SETTLEMENT OF THIS COMMERCIAL DISPUTE IS BUT ANOTHER EXAMPLE OF ECONOMIC AND POWER INTERESTS OF INDIVIDUALS CLOSE TO THE PALACE INTERFERING WITH THE OVERALL PHILIPPINE ECONOMIC INTERESTS. THE
CONFIDENTIAL

CONFIDENTIAL

PAGE 03 MANILA 14462 02 OF 02 201537Z

FACT THAT CALTEX CAN BE TREATED SO CAVALIERLY IS A BAD OMEN FOR FIRMS PLANNING TO INVEST HERE. THIS IS PARTICULARLY TRUE OF PLANNED INVESTMENTS IN ANY ASPECT OF THE PETROLEUM INDUSTRY. WATCHING VELASCO OPERATE IN THIS AND SIMILAR CASES OVER THE PAST YEAR, WE ARE FORCED TO ASK POTENTIAL U.S. INVESTORS IN THE PROPOSED PETRO-CHEMICAL PROJECT TO CONSIDER CAREFULLY WHETHER THEY

REALLY WANT VELASCO SITTING UPSTREAM OF THEIR FEED-
STOCK. THIS PRICE DISPUTE COULD HAVE BEEN SETTLED
AMICABLY TO THE BENEFIT OF GREATER MANILA ELECTRICITY
CONSUMERS, LEAVING CALTEX BURNED BUT NOT BITTER.
INSTEAD, VELASCO AND ROMULADEZ INSISTED ON THEIR POUND
OF FLESH, AND TOOK CALTEX'S HEART AS WELL. END
COMMENT.
SULLIVAN

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